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New Zealand

Dairy and Products Annual Report 2012

Milk Production and Dairy Product Exporting in New Zealand

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Report Highlights:

NZ milk production is expected to decline modestly in 2013 and is forecast at 20.2 MMT. Whole milk powder remains the product of choice for NZ dairy processors, with production expected to remain stable in 2013 at 1.25 MMT, while exports are projected to increase to 1.275 MMT. Fonterra, NZ's largest dairy processor and exporter, is effecting major changes to its constitution.

Executive Summary:

Excellent pasture growing conditions that have supported impressive gains in dairy production over the past 18 months are not expected to carry on indefinitely. Assuming a more normal weather pattern and stable cow numbers, NZ milk production in 2013 is forecast at 20.20 million metric tons (MMT), slightly lower (nearly 1%) than last year's estimated production level of 20.35 MMT. 2012 production was 7% higher than in 2011, which in turn was 10% higher than in 2010. Taking into account that cow numbers have only risen by about 7% over the two-year period (2011-2012), the production increases are a testament to the considerable genetic potential of the national herd that was just waiting to be expressed under the right environmental conditions.

Whole milk powder is expected to remain the product of choice for NZ dairy processors. Although milk supply is expected to decline (marginally) in 2013, WMP production is forecast at 1.25 MMT, the same as the estimated 2012 production level, which is about 10% higher than in 2011. In 2012, production capacity has been expanded by the addition of a new 15 MT/hr powder drier (75-100,000 MT/year); this will be followed in 2013 by the addition of a 30 MT/hr drier (up to 200,000 MT/year).

In response to a smaller milk supply, production of cheese, butter/anhydrous milkfat, and skim milk powder are all expected to decline slightly in 2013. In 2012, cheese production is expected to be up 14.8% year-on-year and is estimated at 310,000 MT; butter/AMF up 5.7% at 499,000 MT; followed by SMP up 6.6% at 390,000 MT. Basically all the result of the big increase in milk supply during 2012.

Over 95% of New Zealand's dairy production is exported in one form or another, thus as production increases so too do exports. Inventories are forecast to be up approximately 20% at the end of 2012, moderating the between year changes in export shipments. For 2013 total PSD commodity exports are forecast at 2.53 MMT a 3.5% increase on the 2012 estimated export level of 2.45 MMT, which in turn is about 6.6% ahead of 2011 exports.

WMP is consistently the standout performer growing from an estimated export level of 1.218 MMT in 2012 to a forecast of 1.275 MMT in 2013. Cheese is enjoying somewhat of a reprieve at the moment and is expected to buck a trend of reduced exports since 2006 and come in with exports of around 275,000 MT for both 2013 and 2012.

On the regulatory front, Fonterra, which processes approximately 89% of the milk produced in New Zealand, is expected to implement "Trading Among Farmers" (TAF) by the end of 2012. TAF, a huge constitutional shift, is designed to substantially remove redemption risk from the Cooperatives balance sheet. The proposed changes have not been without controversy.

Commodities:

Dairy, Butter

Dairy, Cheese

Dairy, Dry Whole Milk Powder

Dairy, Milk, Fluid

Dairy, Milk, Nonfat Dry

Milk Production

Dairy, Milk,	201	2011		.2	201	2013	
Fluid		Market Year Begin: I Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
New Zealand	Official	New Post	Official	New Post	Official	New Post	
Cows In Milk	4810	4816	4890	5021		5021	
Cows Milk Production	18965	18965	19874	20348		20196	
Other Milk Production	0	0	0	0		0	
Total Production	18965	18965	19874	20348		20196	
Other Imports	2	2	2	1		1	
Total Imports	2	2	2	1		1	
Total Supply	18967	18967	19876	20349		20197	
Other Exports	123	123	125	100		120	
Total Exports	123	123	125	100		120	
Fluid Use Dom. Consumed.	300	300	300	300		300	
Factory Use Consumed.	18494	18494	19401	19899		19727	
Feed Use Dom. Consumed.	50	50	50	50		50	
Total Dom. Consumption	18844	18844	19751	20249		20077	
Total Distribution	18967	18967	19876	20349		20197	
CY Imp. from U.S.	0	0	0	0		0	
CY. Exp. to U.S.	0	0	0	0		0	
TS=TD		0		0		0	
(1000 Hd, 1000MT)							

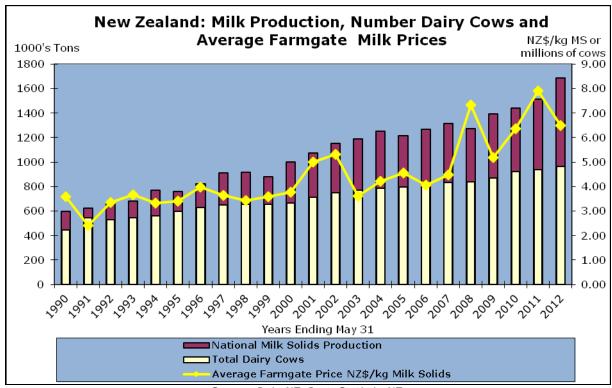
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2013

The run of excellent weather conditions has to come to an end at some point and with it the extraordinary production increases. Assuming more normal weather conditions in the coming year, total milk production is expected to decline marginally (almost 1%) in 2013 and is forecast at 20.2 million metric tons (MMT). The factors underpinning the 2013 forecast are:

- Neither El Nino nor La Nina weather patterns are predicted at present, which should lead to relatively normal pasture growth over the first half of 2013.
- Given these conditions, North Island milk supply is expected to decline significantly in the first half of 2013. While cow numbers will likely remain stable, the cows are not likely to benefit from the same quality or quantity of forage as was available in the first half of 2012, thereby reducing the per head performance.
- To some extent, the decline in North Island production will be offset by continuing production increases in the South Island as new dairy farm conversions begin to contribute more significantly to the overall milk supply. Additionally, weather variability in the Southern Island is mitigated to a large degree by the ability of many farmers to irrigate.

• A lower milk price outlook will tend to put a dampener on farmers purchasing supplementary feed to boost production unless they can see a clear financial margin.



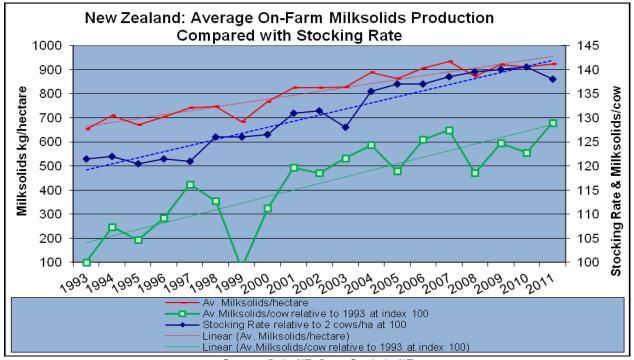
Source: DairyNZ, Post, StatisticsNZ,

2012

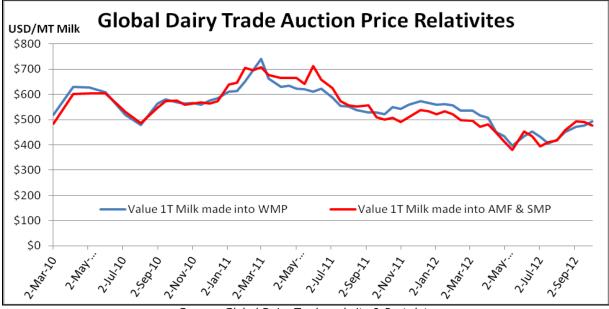
Excellent pasture conditions in 2012 have supported strong growth in milk output; consequently, the estimate for 2012 milk production was revised upward to 20.35 MMT, 7.3% ahead of estimated 2011 production level. This is an incredible result, as it comes on the heels of a 10% increase in 2011 compared to 2010. Considering cow numbers have only risen approximately 7% over the two year period, the result is testament to the considerable genetic potential of the NZ dairy herd that was just waiting for the right environmental conditions to be expressed. More specifically, the following factors have also contributed to the 2012 result:

- Cow numbers increased by 205,000 head during 2012 (up 4.3%).
- This was due in part to an estimated additional 125 dairy farm conversions contributing around 100,000 cows and an unexpected increase in existing farm cow numbers of 120,000 head. Improved nutrition in 2011 allowed for a greater number of cows to get in calf and be kept on farm through 2012.
- Improved nutrition for a sustained duration has meant cows were maintained in better condition and calved down in August/September 2012 better than normal, thereby setting the scene for higher production.

- During the first half of 2012 farmers were operating under a forecast milk price that was relatively high providing them the confidence to purchase or accumulate supplements to increase production.
- Even though the milk price outlook for the 2nd half of 2012 has dampened, farmers have carried adequate supplies of supplementary feed into the period and at this stage don't need to purchase higher than normal amounts of feed.



Source: DairyNZ, Post, StatisticsNZ



Source: Global Dairy Trade website & Post data

Dairy Product Manufacture

Whole Milk Powder (WMP)

Dairy, Dry	20	2011)12	20	13	
Whole Milk Powder	Market Year Begin: Jun 2011			r Begin: Jun)12	Market Year Begin: Jun 2013		
New Zealand	Official	New Post	Official	New Post	Official	New Post	
Beginning Stocks	100	100	115	130		161	
Production	1,125	1,141	1,217	1,250		1,250	
Other Imports	1	1	1	1		1	
Total Imports	1	1	1	1		1	
Total Supply	1,226	1,242	1,333	1,381		1,412	
Other Exports	1,110	1,110	1,200	1,218		1,275	
Total Exports	1,110	1,110	1,200	1,218		1,275	
Human Dom. Cons.	1	2	1	2		2	
Other Use, Losses	0	0	0	0			
Total Dom. Cons.	1	2	1	2		2	
Total Use	1,111	1,112	1,201	1,220		1,277	
Ending Stocks	115	130	132	161		135	
Total Distribution	1,226	1,242	1,333	1,381		1,412	
CY Imp. from U.S.	0	0	0	0		0	
CY. Exp. to U.S.	1	2	0	2		2	
TS=TD		0		0		0	
(1000 MT)							

Not Official USDA data

2013

WMP is expected to remain the product of choice for NZ dairy product manufacturers. Forecast at 1.25 MMT, production in 2013 is forecast to be equivalent to the estimated 2012 production level. However, most other product formats are likely to be slightly reduced in volume terms in line with the slight decrease in milk supply.

Fonterra is set to commission a new drier in the South Island in 2013, which will be largest capacity drier in the world capable of producing up to an estimated 200,000 MT of powder a year. While this capacity is unlikely to immediately change the relative tonnages of different product formats, it will give the flexibility to produce the most profitable formats from more of the milk supply. For example it will enable other processing capacity to be switched to nutritional powder production that can be significantly more profitable. Nutritional powders are the main ingredient for infant formula and geriatric nutritional products.

2012

A big jump in WMP production is expected in 2012, which estimated at 1.25 MMT, a 9.6% year-on-year gain. The main factors leading to this boost include:

• Increased milk supply in 2012

- Additional processing capacity built over the last 10 years has been directed to powder driers that are either dedicated WMP driers or multi-format WMP and SMP/AMF set ups.
- In August 2012 a new 15 MT/hour drier was commissioned in the South Island which has an annual production capacity of somewhere on the order of 75,000 to 100,000 MT.
- WMP is typically cheaper to produce than any other format (apart from liquid milk).
- The value of a ton of milk made into WMP maintains its similarity to or advantage over the pricing for the other main commodity formats (see GDT chart above).
- Year to date (August 2012), export statistics show WMP shipments are up approximately 18% which would support estimates that production is up significantly.

Butter and Anhydrous Milk Fat (AMF) Products

Dairy, Butter New Zealand	2011 Market Year Begin: Jan 2011		2012 Market Year Jan 20	Begin:	2013 Market Year Begin: Jan 2013	
(1000 MT)	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	50	50	45	55		54
Production	459	472	495	499		490
Other Imports	1	1	1	1		1
Total Imports	1	1	1	1		1
Total Supply	510	523	541	555		545
Other Exports	448	448	470	480		474
Total Exports	448	448	470	480		474
Domestic Cons.	17	20	20	21		21
Total Use	465	468	490	501		495
Ending Stocks	45	55	51	54		50
Total Distribution	510	523	541	555		545
CY Imp. from U.S.	0	0	0	0		0
CY. Exp. to U.S.	22	22	17	28		28
TS=TD		0		0		0

Not Official USDA data

Note: Anhydrous Milk Fat (AMF) is adjusted in the tables and in the narrative to butter equivalents by multiplying AMF tons by 1.22.

2013

Butter/AMF production in 2013 is forecast at 490,000 MT, slightly lower (1.8%) than the estimated 2012 production level. The trade reports some uneasiness with regard to fat demand and relative pricing among dairy products at the moment. Combining this sentiment with the likelihood of a lower milk supply in 2013 and processors continued emphasis on the production of WMP; it is unlikely that there will be a production increase in Butter/AMF 2013. However, this line of thinking could be reversed depending on how far the current downturn in milk production in the U.S. deepens and how production in the EU trends over the first half of 2013. If supplies of fat tighten up much more, there will be a price bounce which would make the manufacturing of AMF and SMP more profitable than WMP and encourage a production switch. In addition, fat prices can often be

pulled along by cheese pricing. So a shortening of northern hemisphere milk supply would be positive on two fronts for fat production in NZ.

2012

With milk supply up significantly, fat production is expected to follow suit and record a 5.7% year-on-year increase to reach an estimated 499,000 MT in 2012. This estimate is supported by:

- Year-to-date (Aug) exports are reported to be 44,000 MT higher than during the same period in the previous year.
- At present some members of the trade are saying that AMF and SMP production is more profitable than WMP.
- Processors find it difficult to keep pace with the increase in milk supplies during the peak
 annual flow period (October to December), and it is generally quicker for them to process
 milk into AMF and SMP utilizing two processing lines, than to produce WMP. With this year's
 increased supply of milk, processors will no doubt be stretched to the max, which would
 support a forecast that fat production in Q4, 2012 will be similar to 2011.

Skim Milk Powder/Non-Fat Dried Milk

2013

Production of SMP/NFDM in 2013 is forecast at 380,000 MT, 2.6 percent lower than the estimated 2012 production level. The following factors indicate this is the most likely scenario:

- Milk supply is likely to decrease slightly, so any increase in SMP production means there would need to be a corresponding decrease in WMP or Milk Protein Concentrate (MPC's are basically concentrated SMP with the lactose removed). This is not envisaged.
- Relative prices for a ton of milk made into SMP and AMF versus WMP are evenly poised at the moment (see GDT Auction pricing chart above), which would suggest that the current manufacturing split between the formats is likely to be maintained into 2013.

2012

Combining the effect of greater milk supply and the likelihood of increased fat production means SMP (the protein component of milk used for fat production) will most likely increase in 2012. Total production in 2012 is estimated at 390,000 MT, a 6.6% improvement over 2011. The following factors also have a role to play in determining production levels.

- Reiterating the factor from the fat discussion: at the peak spring milk flush when plants are running at full capacity it is often quicker to make SMP and AMF utilizing two production lines, but the process is generally slightly more expensive.
- While the South Island has additional drier capacity for the 2nd half of 2012, peak milk flows in the North Island could easily surpass 2012 levels necessitating greater SMP and AMF manufacturing just to process all the milk in a timely manner.
- SMP production is heavily dependent on the outlook for fat demand and pricing, being the co-product of the same production process.

 Some protein from the fat/protein separation process goes to Milk Protein Concentrates; Casein/Caseinates and Whey Proteins. However the markets for these products while valuable are finite. Nevertheless production of these products in 2012 is likely to be up 4-6% limiting the total increase of SMP production.

Dairy, Milk, Nonfat Dry New Zealand	2011 Market Year Begin: Jan		2012 Market Year B	egin: Jan	2013 Market Year Begin: Jan		
(1000 MT)	2011		2012		2013		
(1000 M1)	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post	
Beginning Stocks	50	50	47	53		70	
Production	360	366	380	390		380	
Other Imports	2	2	2	5		4	
Total Imports	2	2	2	5		4	
Total Supply	412	418	429	448		454	
Other Exports	362	362	365	375		390	
Total Exports	362	362	365	375		390	
Human Dom. Cons.	3	3	3	3		4	
Other Use, Losses	0	0	0	0		0	
Total Dom. Cons.	3	3	3	3		4	
Total Use	365	365	368	378		394	
Ending Stocks	47	53	61	70		60	
Total Distribution	412	418	429	448		454	
CY Imp. from U.S.	0		0				
CY. Exp. to U.S.	0	1	0	1		1	
TS=TD		0		0		0	

Not Official USDA data

Cheese Production

2013

With a projected slight decline in the milk supply it is hard to see cheese production maintaining the production levels achieved in 2012. Consequently, it is expected that production will decline in 2013, to a forecast level of 290,000 MT, a year-on-year decrease of nearly 6.5%. The level of cheese production is typically determined by:

- Generally, cheese plants are only run during the peak milk supply months.
- With additional powder capacity coming on line during 2013 and a peak milk flow likely to be similar to 2012 the pressure to produce extra cheese just to process all the milk won't be as great in 2013.
- Higher manufacturing costs in NZ means cheese prices need to be relatively higher than WMP or SMP/AMF before there would be a discretionary choice to produce cheese.
- Whey product (the co-product of cheese manufacture) prices can determine the economics
 of a cheese plant. At present they are running at a high level and this is expected to be
 maintained.

Doing Change	2011	2012	2012
Dairy, Cheese	2011	2012	2013

New Zealand	Market Year Begin: Jan 2011		Market Year Begin: Jan 2012		Market Year Begin: Jan 2013	
(1000 MT)	USDA Official	New Post	USDA Official	New Post	USDA Official	New Post
Beginning Stocks	40	40	22	32		42
Production	250	270	275	310		290
Other Imports	5	5	5	5		5
Total Imports	5	5	5	5		5
Total Supply	295	315	302	347		337
Other Exports	253	253	260	275		275
Total Exports	253	253	260	275		275
Human Dom. Cons.	20	30	20	30		30
Other Use, Losses	0	0	0	0		0
Total Dom. Cons.	20	30	20	30		30
Total Use	273	283	280	305		305
Ending Stocks	22	32	22	42		32
Total Distribution	295	315	302	347		337
CY Imp. from U.S.	0	0	0	1		1
CY. Exp. to U.S.	2	2	2	3		3
TS=TD		0		0		0

Not Official USDA data

2012

Cheese production is 2012 is estimated at 310,000 MT. This is 40,000 MT or 14.8% ahead of the estimated 2011 production level. The main factors behind this significant change are:

- Milk supply is up necessitating extra cheese production.
- Exports through August 2012 are 24,000 MT higher than in the same period in 2011.
- The peak milk flow months for the year are still to come, and it is expected the peak will challenge last year's phenomenal flows so it is likely over the final quarter of the year cheese production will be at least maintained at levels similar to 2011.
- One processor has reported that cheese production is returning them the highest margins over WMP or SMP/AMF at present.

Trade and Inventories

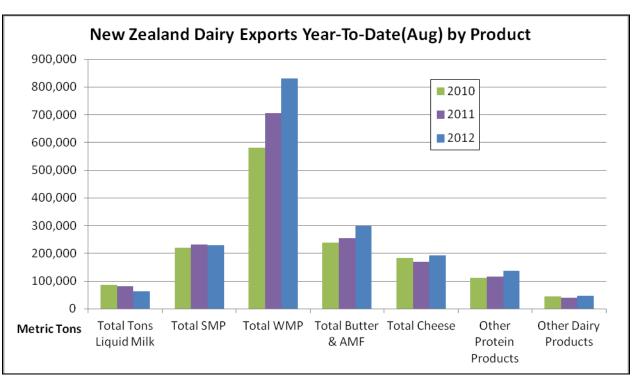
New Zealand	New Zealand PSD Summary Table for Dairy Product Export Projections											
PSD Commodity	Actual	Fore	casts	2013 % change from 2012	2012 % change from 2011							
(1000 MT)	2011	2012 2013										
WMP	1,110	1,218	1,275	4.7%	9.7%							
SMP	362	375	390	4.0%	3.6%							
Butter/AMF	448	480	474	-1.3%	7.1%							
Cheese	253	275	275	0.0%	8.7%							
Liquid Milk	123	100	120	20.0%	-18.7%							
Sub-total Excluding Liquid Milk	2,173	2,348	2,414	2.8%	8.1%							
Total PSD Exports	2,296	2,448	2,534	3.5%	6.6%							

Source: PSD tables

	New Zealand Dairy Product Export Destinations Annual Series: 2006 - 2011										
			United Sta	ites Dollars			% Chan ge	% Mark			
Destinati on Country	2006	2007	2008	2009	2010	2011	2010 to 2011	et Share 2011			
China	280,300,05	317,730,44 8	374,212,47 6	667,100,79 7	1,387,668, 441	1,788,885,5 85	28.9%	17.5%			
United	528,417,65	621,199,66	705,889,14	541,790,68	514,622,52	673,265,04					
States Japan	287,210,25	379,975,13 0	486,583,88	315,095,64 0	404,797,95 0	469,192,18 9	30.8% 15.9%	6.6% 4.6%			
Australia	219,069,99	275,360,65	366,541,55 8	259,414,03 6	396,888,01 7	426,393,14	7.4%	4.2%			
Philippin es	234,286,99	384,007,27	386,339,32	260,750,45	389,398,48	414,122,03	6.3%	4.1%			
Algeria	129,897,90	168,175,63	212,607,50	156,116,12	164,667,79	389,919,08	136.8	3.8%			
Saudi Arabia	196,323,23	292,797,43	370,671,89 6	191,141,26 2	286,994,43	389,862,48 5	35.8%	3.8%			
Venezuel a	109,767,18	261,790,08	466,664,81	224,827,72	334,980,02	378,373,32	13.0%	3.7%			
Malaysia	151,115,93	273,092,77	370,767,50 6	222,863,84	286,114,71	366,393,50 6	28.1%	3.6%			
UAE	81,049,081	75,873,247	89,628,872	150,276,69 0	196,673,98 7	323,558,63 0	64.5%	3.2%			
Rest of World	2,452,234, 600	3,311,163, 291	3,540,206, 610	2,737,478, 761	3,782,844, 295	4,580,433,2 43	21.1%	44.9%			
Total	4,669,672,	6,361,165,	7,370,113,	5,726,856,	8,145,650,	10,200,398,	25.2%	100.0			

Exports 886 652 600 013 665 270 %

Source: Global Trade Atlas

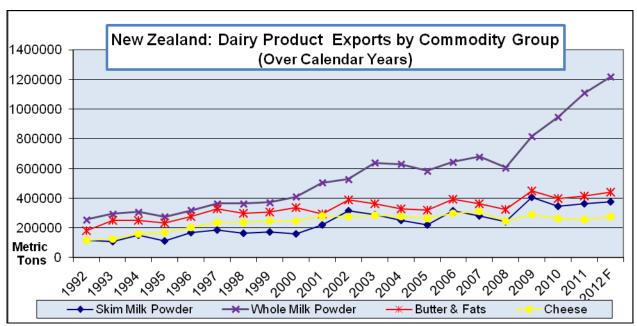


Source: Global Trade Atlas

	New Zealand Dairy Product Export Destinations											
	Year To Date: January - August											
Partner	U		% Share		% Change							
Country	2010	2011	2012	2010	2011	2012	2012/2011					
China	814,156,477	1,191,213,979	1,367,037,983	16.1%	18.0%	20.0%	14.8%					
United States	329,815,504	414,098,532	479,852,947	6.5%	6.3%	7.0%	15.9%					
Venezuela	154,162,643	188,679,548	313,359,342	3.1%	2.9%	4.6%	66.1%					
Japan	271,353,440	316,780,932	306,900,031	5.4%	4.8%	4.5%	-3.1%					
United Arab Emirates	133,273,863	205,933,273	276,145,837	2.6%	3.1%	4.0%	34.1%					
Philippines	258,378,841	268,813,478	256,551,945	5.1%	4.1%	3.8%	-4.6%					
Malaysia	190,303,517	245,686,501	256,058,520	3.8%	3.7%	3.8%	4.2%					
Saudi Arabia	168,604,400	271,272,970	239,762,721	3.3%	4.1%	3.5%	-11.6%					
Indonesia	188,067,854	212,819,965	238,928,832	3.7%	3.2%	3.5%	12.3%					
Australia	263,668,868	275,989,195	232,569,956	5.2%	4.2%	3.4%	-15.7%					
Egypt	95,300,321	133,407,361	203,729,056	1.9%	2.0%	3.0%	52.7%					
Algeria	100,131,745	268,452,206	193,038,262	2.0%	4.1%	2.8%	-28.1%					
Singapore	176,817,738	192,658,376	184,426,945	3.5%	2.9%	2.7%	-4.3%					
Sri Lanka	137,372,143	168,208,563	169,628,323	2.7%	2.5%	2.5%	0.8%					
Thailand	131,413,282	185,217,367	147,976,991	2.6%	2.8%	2.2%	-20.1%					

Rest of the							
World	1,639,567,789	2,064,519,096	1,956,225,995	32.5%	31.3%	28.7%	-5.2%
World Total	5,052,388,418	6,603,751,347	6,822,193,686	100%	100%	100%	3.3%

Source: Global Trade Atlas



Source: Global Trade Atlas

Discussion – the Impressive Rise in Whole Milk Powder Production

New Zealand exports in excess of 95% of its total dairy production. The dairy sector has developed over a long period to survive and prosper under such a regime. Cows are bred primarily for protein production and now achieve milk protein levels well in excess of many other herds around the world. Processors have become very efficient at taking the water out of milk so it can be shipped relatively cheaply and used as the raw ingredient for a multitude of end products all around the world.

Overwhelmingly, with some notable exceptions, the markets for New Zealand dairy products are in countries that don't have a well developed domestic dairy sector. WMP fits very well into this trade because it can be put to a variety of end uses notably reconstituted liquid milk, and fast moving consumer goods (FMCG).

The chart above documents the meteoric rise of WMP exports especially over the last 4 years with an average increase on the order of 100,000 MT per year. New Zealand is the prime player in world trade for WMP contributing approximately 45% of the total volume traded. With regard to China, NZ supplies 93% of the total imports of WMP into the PRC. In addition NZ exports WMP to an additional 112 countries around the world.

While exports to China have been the primary driver in the growth of WMP exports, the rise in exports to other countries has also been impressive, having increased by 72% since 2006. At the same time the average export price has risen by 73%. In addition, New Zealand processors have continued to drive the efficiency of production up while at the same time adhering to product specifications and the levels of service demanded by their customers. By mid-2013, New Zealand will have the manufacturing capability to push WMP exports to close to 1.5 MMT in the next 2 to 3 years.

Fonterra's "Strategy Refresh" completed this year under the new CEO points to a stronger focus on serving and developing markets in China, ASEAN, Latin America, and the Middle East/North Africa. At the same time, Fonterra is looking to downsize its marketing force in the U.S. and is quoted as saying it is "rightsizing" its operations in the United States.

While NZ has a dominant and very competitive position in world trade for WMP, this situation is not likely to last indefinitely. Already other countries are starting to install WMP capable driers to satisfy what looks to be ongoing demand increases for WMP.

New Zealand processors are already looking beyond just commodity level WMP and are moving toward a greater number of value added products. Most of the development is in the nutritional powder format, either making complete infant formula or the value added ingredients needed in the final formulation. Nations in the fast growing developing world are the target markets. In addition there is potential to further develop cream products away from commodity level fats to specific ingredients for use in such sectors as food service.

New Zeala	nd Expor	t Statistic	s for Wh	ole Milk P	owder	
Destination		For C	alendar Yea	rs in Metri	C Tons	
Destination	2006	2007	2008	2009	2010	2011
China	61,542	51,237	44,800	171,491	294,408	302,261
Venezuela	42,803	74,043	98,922	78,213	97,021	90,078
Algeria	37,106	37,533	49,101	59,801	45,178	79,602
UAE	26,638	17,408	12,852	44,572	43,424	67,700
Sri Lanka	49,277	53,554	48,320	45,020	57,091	64,398
Malaysia	30,627	40,567	46,108	35,266	31,231	38,218
Saudi Arabia	40,620	40,056	32,345	34,851	28,538	37,701
Singapore	17,872	10,879	18,932	25,537	32,274	36,634
Thailand	21,261	22,752	18,206	19,960	28,757	30,760
Indonesia	28,383	28,000	42,888	32,887	23,342	29,955
Rest of World	288,453	303,664	194,134	270,482	267,437	332,325
Total for all Destinations	644,578	679,695	606,611	818,080	948,700	1,109,635
World Av.Price/MT	\$2,180	\$3,021	\$4,244	\$2,299	\$3,300	\$3,780

Source: Global Trade Atlas

New Zealand D	airy Produ	uct Export	Statistics	To Unite	d States				
(Quantity (T), USD, USD/T)									
Calendar Years 2006 2007 2008 2009 2010 2011									
Liquid Milk (T)	0	512	931	582	120	0			
SMP	200	204	86	178	203	513			
WMP	2919	1830	693	3233	328	2399			
Consumer Products	14	30	173	81	60	33			
Milk Protein Concentrates	48209	50289	47752	41850	43654	46353			
Butter & Fats	24439	27851	20497	31496	18502	18931			
Cheese	29421	26356	16549	17465	5291	1875			
Casein	34881	43947	37628	32022	22999	29456			
Whey Products	4821	5635	4367	6674	5179	4628			
Other Products incl Lactose	130	44	111	99	103	137			
Total Quantity (T) Exported	145034	156698	128787	133680	96439	104325			
Total Value in millions USD	\$528.4	\$621.2	\$705.9	\$541.8	\$514.6	\$673.3			
Average Price in USD/Ton	\$3,643	\$3,964	\$5,481	\$4,053	\$5,336	\$6,454			

Source: Global Trade Atlas

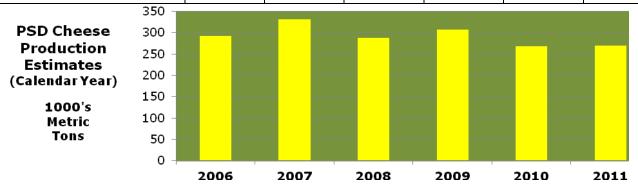
New Zealand Dairy Product Export Statistics To China							
(Quantity (T), USD, USD/T)							
Calendar Years	2006	2007	2008	2009	2010	2011	
Liquid Milk(T)	1962	3084	4611	5585	8168	18747	
SMP	34709	16021	19275	50199	50790	77474	
WMP	61542	51237	44800	171491	294181	302261	
Consumer Products	258	181	168	3874	2987	2451	
Milk Protein Concentrates	802	2141	1258	1715	1383	1785	
Butter & Fats	12093	10886	11146	26720	19351	34451	
Cheese	4188	6209	6259	9222	11702	13535	
Casein	2580	1895	1549	3199	4872	6336	
Whey Products	6260	5254	8271	8889	7806	10510	
Other Products incl Lactose	1818	244	1316	4103	328	261	
Total Quantity (T) Exported	126212	97152	98653	284997	401568	467811	

Total Value in millions USD	\$280.3	\$317.7	\$374.2	\$667.1	\$1,387.7	\$1,788.9
Average Price in USD/Ton	\$2,221	\$3,270	\$3,793	\$2,341	\$3,456	\$3,824

Source: Global Trade Atlas

Cheese Comment

New Zealand Export Statistics for Cheese							
Destination	For Calendar Years in Metric Tons						
	2006	2007	2008	2009	2010	2011	
Japan	58,890	67,346	51,432	46,325	53,346	61,175	
Australia	50,766	50,299	44,982	52,349	54,289	46,471	
Korea, South	11,527	15,787	18,062	17,161	19,210	20,085	
China	4,187	6,210	6,260	9,222	11,702	13,536	
Philippines	8,926	10,533	9,066	11,447	10,867	10,186	
Indonesia	2,634	5,029	5,742	7,905	7,718	8,800	
United Kingdom	11,775	9,773	8,612	12,847	8,897	7,924	
Saudi Arabia	11,417	13,062	9,670	12,620	8,843	6,940	
Taiwan	6,340	7,188	5,648	7,279	7,126	6,865	
Bahrain	697	1,505	7,471	10,246	8,147	6,736	
Rest of World	110,930	100,008	59,535	81,344	57,331	50,103	
Total for all Destinations	299,008	309,214	246,894	290,097	264,819	252,858	
World Av.Price/MT	\$2,695	\$3,121	\$4,539	\$2,923	\$3,919	\$4,271	



Source: Global Trade Atlas, USDA PSD

Cheese exports are expected to reverse their downward trend, and increase to around 275,000 MT in both 2012 and 2013. Exports for the eight months to August 2012 are 24,000 MT ahead of the previous year, and with milk supply running at such high levels, that is likely to necessitate continued elevated levels of cheese production through mid 2013. Over the last decade NZ cheese factories have not been operated at full capacity until the peak of the milk supply season October through December. However as WMP production capacity has increased, especially from 2010 on, cheese production seems to be changing to be geared more to export demand.

Compared with WMP, demand for internationally traded cheese is somewhat limited. In 2011, New Zealand exported cheese to 26 different countries compared with 113 countries for WMP. Between 2006 and 2011 the export volume for cheeses fell 15%, while the price appreciated 59%.

Many of the countries which are avid consumers of milk powders from New Zealand do not have a taste for cheese as it is not part of their traditional diets. Many countries in Asia fit into this category. It is hard work to increase consumption of cheese as a food item on its own. But westernization of diet with the likes of fast food chains such as McDonalds spreading through these countries is driving an increase in cheese as an ingredient. The exception to this is Japan where people were introduced to the taste of New Zealand and Australian cheese after the Second World War and now have a preference for it over and above other origins. New Zealand has a low tariffrate cheese quota into Japan which makes it a profitable market to supply. Fonterra has just announced it is building an extension to one North Island cream cheese factory which will double its production to 20,000 MT. The target markets are Asia and Japan. Cream cheese is mostly used as an ingredient, often in baked goods.

Inventory Comment

Stocks held at the end of 2012 are likely to be increased over those held at end 2011, and this increase is estimated to be in the order of 67,000 MT (for the PSD commodities analyzed), an approximate rise of 20%. This is likely to be a consequence of the increased milk flows in spring 2012 resulting in the seasonal highs in stock on hand being slightly greater than normal, and some desire by exporters to delay shipping slightly in order to capture the higher prices which are predicted going into 2013. It is estimated that by the end of 2013 stocks will have been reduced by a similar amount as the increase in 2012.

Exporters report that there was virtually no carryover of uncommitted stocks from the 2011/12 production season into 2012/13. While this is promising for the 2012/13 exporting campaign, some commentators are postulating that the off-shore dairy product manufacturers and re-sellers may have stocked up while prices were relatively lower so may not be in a hurry to increase their purchasing plans.

Sector Policy Developments

Fonterra's "Trading Among Farmers" and the Dairy Industry Restructuring Act

On the June 25^{th,} 2012, New Zealand dairy farmers who are shareholders of Fonterra (the country's leading cooperative milk processor/dairy products marketer, collecting about 89% of all milk produced in New Zealand) re-affirmed their support for changes to the cooperative's constitution, entitled "Trading Among Farmers" (TAF). Under TAF, Fonterra would no longer be required to issue and redeem farmer shares on <u>demand</u>, instead an exchange would be created that would allow farmers to trade shares among themselves. In addition, a separate fund would be established that for the first time would allow public investment in the performance of Fonterra shares. The public fund is to be established to ensure that adequate liquidity exists in the Fonterra share exchange. However, the public fund would not have voting rights in the Fonterra Cooperative. Under the new arrangement, Fonterra would no longer be required to retain liquidity (up to \$600 million) to cover redemption risk.

Implementation of TAF necessitated changes to the Dairy Industry Restructuring Act (DIRA), the federal legislation which governed the Coops formation and operations. Importantly the freedom of entry/exit to the Coop by farmers was preserved in DIRA. DIRA regulates that the minimum size for the public fund is to be NZ\$500 million. The methodology Fonterra uses to calculate the raw milk price paid to farmers was also encapsulated in DIRA, along with an audit function provided by the Commerce Commission. The amended DIRA was passed in to law on July 23rd, 2012.

These changes have not been without controversy. In the two years it has taken Fonterra to move TAF from an advanced concept to a working system, there has arisen a growing sense of disquiet and unease among Fonterra shareholders as to whether they were going down the right path and concerns were raised that perhaps the changes could lead to the eventual loss of control by farmers of their own company. At the same time, other players in the dairy sector complained that the amended DIRA doesn't go far enough in curbing what in their view were monopolistic tendencies of the biggest player.

It is probably reasonable to comment that under TAF a larger permanent capital base will be made available to Fonterra so it can work its balance sheet harder and effect its global strategy more effectively. However, managing TAF and its ancillary entities will also involve a greater time input and there is a risk that the management of TAF could divert the Board's attention away from the core focus of governing the business.

The Fonterra Shareholders Council (the official shareholders watchdog on the Fonterra Board) have now (Sept 2012) voted overwhelmingly in favor of setting TAF in motion and the whole system is now set to be up and live with the shareholders fund in place by Christmas 2012 if not earlier. There are still some constitutional changes for the Coop to put in place but it is thought they will be voted in at the AGM in late October/early November 2012.